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IFRS 9 elections

An easy but essential pre-holiday season job

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Complete your hedge accounting documentation or your hedges may no longer comply!

There are only a few weeks to go until the holiday season. Before the festivities and parties start in earnest, there are a couple of important actions you need to take – particularly if you're intending to hedge account in 2018.

Why? Because if financial institutions and corporates don't have the relevant documentation in place *before* 1 January 2018, hedge accounting may not be possible – even if you have previously been hedge accounting under IAS 39.

This is an easy problem to fix, here's how.

IFRS 9 or IAS 39?

Firstly, you need to decide whether you want to take advantage of the new hedging rules under IFRS 9 or whether you want to carry on hedge accounting under IAS 39, which you are permitted to do until the IASB has completed its project on accounting for dynamic risk management.

For corporates, there are significant attractions in hedge accounting under IFRS 9 and more opportunities – for example, to do commodities hedging. You'll be able to hedge account for a specific non-financial component of a larger contract, such as the crude oil component of a jet fuel contract, resulting in a more effective hedge.

For banks and financial institutions, meanwhile, there is less incentive to move away from IAS 39. Most banks I've been talking to intend to stay with it, in a spirit of "if it's not broken, don't fix it."

It's not automatic

The key point is that, whatever you decide to do – even if you decide to apply IAS 39 – you have to *actively elect* to do so. You can't do nothing and expect the benefits of hedge accounting to be handed to you.

So, before the New Year, you must document your hedge accounting intentions – i.e. to apply IFRS 9 or IAS 39. This documentation would normally be formally approved by your usual policy governance processes, such as in a Board minute or by the technical accounting committee.

Don't let your hedges vanish

If you plan to apply the new IFRS 9 rules, you will first need to update old hedge documentation that might not comply with the new rules – even if you aren't taking advantage of any of the new permissions in IFRS 9. For example, compliant IFRS 9 hedge documentation should identify the expected sources of ineffectiveness – does your IAS 39 hedge documentation do that? If you don't do this, you might be unable to apply hedge accounting to your hedging arrangements until your documentation is complete and compliant.

If you are taking advantage of the new permissions, there are additional decisions to make. For example, if you plan to use of a cost of hedging reserve technique to defer currency basis or forward points, will you do this retrospectively or prospectively?

A host of other decisions too

Beyond that, there is a whole range of decisions that need to be made across classification and measurement, impairment, transition and hedging that are related to the date of application, as we have summarised in this checklist.

Whilst not all decisions have to be made before the date of application, I'm encouraging all of my clients to make decisions sooner rather than later.

Hindsight: not such a wonderful thing

IAS 8 is clear that hindsight should not be used when applying a new accounting policy to a prior period. Consistent with that principle, if decisions are made after the date of initial application, it may not be possible to demonstrate that they have been made solely using information available on that date.

For example, equity investments should be classified as either fair value through P&L or fair value (irreversibly) through other comprehensive income. Suppose you hold equities that halve in value before you make this accounting choice on 1 March 2018. How are you going to be sure, and convince others, that your decision to put those equities as fair value through OCI was based only on the facts and circumstances on 1 January 2018?

It could lead to lengthy wrangles and debates. Much better to make those decisions at the earliest opportunity and have them documented by the date of application if possible, in tune with the spirit of the new standard.

About the author

Colin provides technical accounting advice to financial institutions and corporates globally on the application of IFRS 9.

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IFRS 9 transition checklist

Decisions/actions to be taken before the date of initial application (DIA)* of IFRS 9

QUESTION: Have you…	Yes	No	Supplementary information (Only available on desktop)
1. Elected to continue to apply IAS 39's hedge accounting requirements or to apply the new IFRS 9 general hedging model?			
2. If applying the IFRS 9 general hedging model:			
– put in place new hedges based on additional exposures that now qualify as hedged items or new classifications of financial assets?			
– decided to designate qualifying credit exposures at FVTPL?			
– decided whether and how to apply the cost of hedging approach for hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter?			
– assessed compliance with IFRS 9 hedge accounting criteria and updated hedge documentation before the DIA?			
3. Elected the temporary exemption from IFRS 9 if you are an insurer?			

Considerations related to the DIA*/ IFRS 9 transition

QUESTION: Have you…	Yes	No	Supplementary information (Only available on desktop)
4. Elected not to restate comparative information in respect of classification and measurement, including impairment?			
5. Made the required or permitted restatements to comparative information on transition if applying the cost of hedging requirements under the IFRS 9 general hedging model?			
6. Assessed the nature of the business models in which your financial assets are held based on facts and circumstances at the DIA?			
7. Elected to present changes in fair value in OCI for an investment in an equity instrument that is not held for trading?			
8. Designated, or revoked designations of, financial assets or financial liabilities as at FVTPL based on the facts and circumstances at the DIA?			
9. Designated certain own-use contracts as at FVTPL?			
10. Assessed whether presenting the effects of changes in a financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss on the basis of facts and circumstances that exist at the DIA?			
11. Measured unquoted equity investments or related derivatives (previously measured at cost) at fair value at the DIA?			
12. Considered whether an adjustment is required for historical accounting of modifications or exchanges of fixed-rate financial assets or financial liabilities that did not result in derecognition?			
13. As part of the impairment assessment, determined whether there has been a significant increase in credit risk (SICR) since initial recognition or whether that determination at the DIA would require undue cost or effort?			
14. Considered the transitional disclosure requirements?			

* For December year-end companies, the DIA will be 1 January 2018.